RETAIL SALES TAXATION

A THESIS BY

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THESIS

RETAIL SALES TAXATION

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INTRODUCTION

During the last decade we have seen the sales tax rise from obscurity to the point where it warrants the consideration of each and every one of us. The amount of revenue that can be obtained through income, property, and other types of taxation, now in use, is definitely limited. As a result, governmental officials are seeking new sources of revenue to bridge the ever widening gap between income and expenditures. From their point of view the sales tax is ideal -- it provides large amounts of revenue within a relatively short time at a low cost to the government. Government officials are not primarily interested in the manner in which a sales tax will effect the people, but in the resulting revenue. For this reason we must inform ourselves as to the nature of this tax and the actual burden that it will place upon our heavily-laden backs.

This study endeavors to deal with the principles of retail sales taxation that have been practiced for centuries. The history and development of the tax have been traced to bring these principles to the front. Modern sales taxes have been discussed and analyzed to show their importance in our revenue systems. The effect that this tax has upon our daily life is emphasized so that we may weight the tax and thereby formulate an opinion.

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Lyman A. Keith

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CHAPTER I

A HISTORY OF SALES TAX SYSTEMS

PART A. THE SALES TAX IN FOREIGN COUNTRIES

It has been a popular assumption that the sales tax is a new tax, a tax developed by modern economists to cope with modern governmental conditions. Even though the sales tax has received its largest growth since the early 1930's, when it was applied to wipe out governmental deficits resulting from the depression, it would be well to remember that the sales tax has been part of public fiscal systems in this country since the early colonial period, and in European countries since the days when Augustus ruled Rome.

Early European Sales Taxes

There is very little information available about ancient and medieval sales taxes. However, it is known that ancient Athens laid various taxes on the sales of commodities in the market. Egypt, too, had a very unpopular five per cent levy on the sale of all commodities, but was later increased to ten per cent when Egypt was conquered by the Romans. While these taxes served as an example of sales taxes that followed and are important, therefore, they are not outstanding in the field of medieval finance. Perhaps the best known ancient sales taxes were those collected by Rome in the days of Augustus. "He laid a tax of one per cent upon all articles, movable goods, or fixtures sold in the markets or by auction, even at Rome and in the Italian peninsula.. On slaves the duty was two per cent."[1] The Romans levied the sales tax in conquered land just as they dispersed their culture. France and Spain had sales taxes introduced by the Romans which

[1] Drury, History of Rome, Vol. III, Page 721

continued long after the Romans lost control of Western Europe.

Spanish Sales Tax

The sales tax in Spain, known as the "alcavala", was established early in the fourteenth century and continued with variations until the nineteenth century. This particular sales tax has received more attention than any other sales tax of the Old World, due primarily to its continuance of operation. "Starting in the early Middle Ages in the communes, it was introduced as a national tax in 1342. It included virtually all articles and was levied at first at the rate of one per cent, then at five per cent, and later at ten per cent on all sales. The alcavala led to not a little difficulty, but it was continued by the absolute monarchs who were at their wits' end to find some method of balancing the budget. The Spanish economists of the time do not tire of calling attention to the enormities and the unfortunate economic consequences of the alcavala."[2]

The difficulties arising out of the alcavala should be blamed only in part to the excessive rates. The collection of this tax was greatly undermined by the use of exemptions to favored towns and classes, and by heavy exactions from the remaining elements of the population. Adam Smith in the "Wealth of Nations"[3] condems this tax because it taxed business at every stage of production and distribution and for this reason it seriously handicapped commerce and industry. Adam Smith and other economists such as John Stuart Mill also believed that the alcavala was an important factor leading to the economic decay of a once prosperous Spain.

Not content with her own miseries Spain attempted without success to

[2]Seligman, Studies in Public Finance, Page 126

[3]Adam Smith, Wealth of Nations, Book V, Chapter II

carry this tax into the Netherlands. She was, however, successful in bringing the sales tax to the New World through her Mexican colony. In Mexico today similar taxes are applied to a country already overburdened, suffering from its ill-effects as did the mother country.

French Sales Taxes

As early as 1314, France made use of a sales tax when Phillip la Bel initiated a tax of six denier per pound on the sale of provisions. Later, when France was invaded by British armies, these taxes were doubled; but government officials were unable to collect revenues from an infuriated French Middle class. The sales tax met with popular resistance from the time of its inception in France, and for this reason it has never been an important item in the French revenues.

Other Early European Sales Taxes

From ancient Athens the sales tax spread to Rome, and from Rome to France and Spain. By the seventeenth and eighteenth centuries the sales tax had reached Germany and England. In Germany the sales tax met with little success, but was extensively applied in England to provide revenues for her war with France. After the wars, the tax was revised to include only specific items rather than consumption in general. The principles underlying early American Colonial sales taxes were so much like those of European taxes that it is logical to assume that our sales taxes are but an outgrowth of taxes used in foreign lands.

PART B. EARLY AMERICAN SALES TAXES

Federal Sales Tax

During the past one hundred years various attempts have been made to establish a Federal Sales Tax, but without success. The first attempt to establish this type of tax was attempted during the last years of the Civil War when a general sales tax was proposed as a temporary war finance measure. "The main arguments for a general sales tax were many: (a) Due to the uniform rate normally applied collections would be easy. (b) A general sales tax would treat foreign and domestic goods alike and would create no discriminating distinctions. (c) If the general sales tax should operate to remove the middleman in the marketing of goods, the nation would benefit in lower prices from the more direct marketing. (d) The tax would assure a large and certain stream of revenue. (e) It would bear equitably upon consumers because as a proportional tax at a flat rate it would be just and fair. (f) Business would suffer no inconvenience from the light and simple general sales tax.

"Opponents of the sales tax attacked it for diverse reasons: (a) Previous general sales taxes like the alcavala had been iniquitous and disastrous in their burdens upon commerce, industry, and consumers. (b) A general sales tax would seriously retard the ebb and flow of American industry. (c) Such a tax would artificially eliminate middlemen by encouraging direct marketing to consumers and would thereby dangerously undermine the distribution system. (d) A general sales tax would be impracticable in administration because of the inadequate records kept by most business establishments. (e) It would be impossible to satisfactorily define sales for the purpose of taxation."[4]

[4] Buehler, General Sales Taxation, Pgs. 8 & 9

However, the adoption of general sales tax failed due to popular dissent. Instead of adopting a sales tax, the income tax then in effect was continued until 1872, and the other sources of revenue, mainly customs and excises, were so altered that they combined to produce the necessary revenue. For the time being, the sales tax was driven to the background where it remained for nearly fifty years.

Following the World War, proponents of the sales tax advised the adoption of this tax to provide for necessary revenue. They cited the productivity of consumption taxes during the Civil War to prove that the sales tax should be adopted. The opponents of the tax cited the disagreeable consequences of the consumption tax to prove its iniquities. The backers of the sales tax were a well-organized group of business men who wanted a heavy sales tax to provide sufficient revenue so that it would lessen the burden upon their individual enterprises in the long run. If a certain amount of revenue is needed by the government and a relatively large part of this can be obtained by a sales tax, it is only natural to assume that the other sources of revenue will be tapped much less severely.

On the other hand, there was a group opposed to the sales tax. This group, strong in number if not politically, was composed primarily of farmers and laborers who were in the lower income groups and would feel the effects of this type of taxation much more than the business man. Even though they lacked the political "pull" of the business man, their numbers were so great that Congress refused to act on the question, and with the revival of business in 1922, the question passed completely out of discussion. A third and final movement for a Federal sales tax came in 1931, at the beginning of the great depression. (Note that each time a sales tax has been proposed the

country has been under similar economic conditions. In each instance, the proposal has come during a serious budgetary emergency.) Again the measure received the support of the business man who had hopes of finding a way to lessen his tax burden at the expense of another group. Virile opposition to the tax was again furnished by laborers and agrarians, and the House was forced to reject the proposal. Since that time, the sales tax has not come to the front as a means of collecting Federal revenue.

Pennsylvania License Tax

While the Federal government has not been successful in its attempts to establish a sales tax several states of the union have used the sales tax in many different ways. The first American sales taxes were found during the nineteenth century in the Virginias, Delaware, Mississippi, Connecticut and Pennsylvania. The first of the sales taxes in Pennsylvania were license taxes on those merchants doing business in 1821, who dealt in imported liquors.

By 1846, all merchants dealing in foreign or domestic goods were included by the tax law. At present, the Mercantile License Tax is legally based on the privilege of engaging in business and carries the following rates: (1) for retailers, an annual license fee of three dollars plus one mill on each dollar of gross sales; (2) for wholesalers, an annual fee of two dollars plus one-half mill per dollar of gross sales; (3) for dealers at exchange, twenty-five cents per thousand dollars of gross sales (one-quarter mill per dollar).

This tax in Pennsylvania is administered as follows: Mercantile appraisers personally visit each place of business, secure a sworn return, and leave a bill for the tax. The county, if dissatisfied with the return, may examine the books for proof. Collections for the following bienniums are

presented in Table 1.

TABLE 1

COLLECTIONS OF REVENUES

PENNSYLVANIA

1931-1935

Date	Retail Licenses	Wholesale Licenses	Total
May, 1931	6,928,000	1,416,000	8,344,000
May, 1933	5,199,000	1,191,000	6,390,000
May, 1935	4,520,000	1,056,000	5,576,000

Source - Biennial Reports - Auditor-General -- Pennsylvania

This table shows that the tax is of very minor importance; it yields about three per cent of the total state tax receipts. The tax is administered by a dual system of state and local administrators making collection costs high. Mercantile appraisers are paid fifty cents per license and six cents per mile for traveling expenses. County or city treasurers receive twenty-five cents per license plus a graduated commission of collections.

The Virginia Sales Tax

Virginia's sales tax began as a lump sum levy on merchants and gradually changed to a rated tax based on the volume of business. During the Colonial period retail merchants were taxed fifteen dollars per year, wholesale merchants forty dollars per year, regardless of the size or type of business. During the War of 1812, these rates were doubled. In 1843 a departure was made from this system, and licenses were graduated according to gross sales. In 1845, a series of lump sum taxes were used ranging from ten dollars on a volume of twenty-five hundred dollars, to one hundred dollars on a sales

volume of seventy-five thousand dollars. This tax was very important to Virginia during the Civil War, producing about 25 per cent of the total revenue received from taxation. Few changes were made in the system for thirty years. In 1915, a few unimportant changes were made in the process of administration. Not until 1933 were changes made whereby different rates were applied to wholesalers and retailers. There is a dual system of administration whereby state and local assessors examine the records and assess the taxes. Like Pennsylvania, rates are low, and costs of collection high.

Summary of Early American Sales Taxes

Delaware, West Virginia, and Mississippi had sales taxes which were essentially the same as those of Pennsylvania and Virginia. More important than the taxes themselves are those salient features, not necessarily good or desirable features, that characterized all early state sales taxes. They were:

1. The tax represented an endeavor to tax business rather than the consumption of merchandise.
2. The tax usually supplemented some other tax.
3. The tax carried a low rate.
4. The tax applied to both wholesale and retail businesses.
5. The taxes were usually administered by a dual state and local system.
6. Only one return was required per year.
7. Because of low rates, exemptions, and high administrative costs, collection rates were very high compared to modern taxes.

These features while not present in every sales tax system are characteristic of a large portion of the state sales tax systems.

CHAPTER II

MODERN SALES TAX SYSTEMS

The Sales Tax Movement

During 1932 sales taxes were significant as a source of revenue in Mississippi and West Virginia alone. At the close of 1937 general sales taxes were in use in twenty-eight states. In seventeen of these states, single stage taxes were used at rates of one per cent or more. In seven states, multiple stage taxes were used. In all of the others, low rates were employed. Several states made false starts in their original sales tax legislation. In Illinois the original three per cent tax was declared unconstitutional by the State Supreme Court only five days before the first returns were due. Later another tax of two per cent was passed to become effective two months later. Utah inaugurated a three-quarters of one per cent sales tax in 1933 but had to change the rate due to the inadequacy of the original figure.

During 1935 five states and New York City embarked upon a Sales Tax program: Iowa with a two per cent tax; West Virginia changed to a two per cent consumers sales tax; Kentucky repealed its graduated tax on chain stores and added a flat three per cent tax on all retailers; Missouri passed a one-half per cent tax but had to raise this rate twice before it produced the expected revenue. Finally, New York City inaugurated a one per cent sales tax in order to provide revenue for her unemployment program. This is about the only instance where a sales tax has been put into effect to provide revenue for one specific purpose. In 1936, Louisiana came into the field with a two per cent tax and in the following year Alabama and Kansas also entered the field with similar taxes.

To summarize this movement from 1932 to 1937, there has been a large growth in this period in the use of sales taxes. However, it seems safe to say that the movement has lost ground since 1937, especially in view of the fact that Maryland's tax expired in 1936 and was not renewed, the defeat of Idaho's tax in November of 1936, the expiration of the New York State tax of 1933 which was adopted for a fifteen month period, the repeal of the New Jersey tax in 1935, and of Kentucky's in 1937. Also, at a public hearing at the State House in the Spring of 1939, a proposed sales tax in Massachusetts was promptly and firmly defeated. Actually there has been no increase in the number of states using this tax since 1935.

Causes of the Movement

There are two distinct causes why so many states have adopted sales taxes in recent years. First, property owners' incomes have been depleted to the point where even reduced tax levies become difficult to pay. As a result there are delinquencies which reduce the state revenue. Second, the severity and duration of the depression created unemployment and decreased private savings to such an extent that existing revenues, even if maintained, would have been insufficient to meet governmental requirements. The sales tax was introduced to bridge that ever widening gap between governmental incomes and expenditures.

The California Sales Tax

It would be impossible to cover each and every state sales tax in these pages. For this reason, representative states will be taken so that we may see modern sales tax systems in operation.

Probably the best illustration of the sales tax in operation lies in the State of California. Prior to 1933 California was faced with a depleted

treasury and no hope for immediate increases in her already overtapped sources of revenue. A State Board of Equalization was established to solve California's financial problems. On July 31, 1933, the State of California approved a retail sales tax which would become effective on August 31st of the same year, with no date set for the expiration of the tax. It can be removed only be repeal or amendment. California's sales tax is a three per cent levy on the gross receipts from retail sales, leases or rentals of tangible personal property, sales for resale, sales of materials for further processing; isolated or occasional sales were to remain untaxed. The act also provided for certain exemptions that would be made. First, were sales in interstate and foreign commerce; second, sales to the United States government; third, sales of motor vehicle fuel otherwise taxed; and last, the sale of food products consumed off the premises where sold.

The Retail Sales Tax imposes a tax on retailers "for the privilege of selling tangible personal property at retail." The Retail Sales Tax was declared constitutional by the California Supreme Court in Roth Drug, Inc. v. Johnson (1936) 13 Cal. App. (2d) 720. The act does not conflict with either the Federal or the State constitutions by depriving the people of property without due process of law, and does not unreasonably discriminate between different classes of business to which it applies. Thus, the act is constitutional because it applies solely to retailers and not wholesalers, and to tangible, not intangible, property, because it provides for certain specific exemptions and because Section 8½ authorizes the retailer to collect the tax "from the consumer insofar as it can be done".

Changes in the Act

The original sales tax law, however, is not without its changes. In 1935 the taxation of food products was exempt through amendment. This has done much to alleviate the buying public's antipathy to the sales tax. Those who have been forced to spend a relatively large share of their income for food doubtless have found this exemption of appreciable benefit. The wisdom of allowing further exemptions is subject to serious questioning as such exemptions may tend to impair materially the effectiveness of the tax. To be successful, the tax must be applied to the broadest base possible, for its principal value as a source of public funds is the universality of its application. To disturb the base would mean to ruin the tax.

No radical changes occurred in the tax law during the bienniums ended June 30, 1938. This was due to the fact that the tax was operating very efficiently and the administration desired to avoid any changes in the law until they were forced to make them. As a result of efficient operation, many of the complexities which normally arise through the inauguration of a new tax have been eliminated. Much of the growing pain period has passed which gives the State Board of Equalization an opportunity to advance its program of efficient and scientific tax administration.

Importance of the Tax

California is indeed fortunate that this tax program operates so smoothly. Since its adoption in 1933, the sales tax has grown to be the backbone of the tax system of the state. Nearly half the increase in revenues during 1936 resulted from the sales tax and its companion measure, the use tax.[1] The yield of these two taxes for the 88th and 89th fiscal years (July 1, 1936 to June 30, 1937) was $174,999,027. while total revenue

[1] See next page

received by the state was $391,646,037. Comparable figures for the 86th and 87th fiscal years are: $133,602,442. for the sales tax and a grand total of $316,753,032. The total increase in revenue for the bienniums was $74,893,005. while increases from the sales tax were $31,396,585. The cost of these collections in each instance remained at less than two per cent of the total amount collected.[2] It is well to note that there was an increase in the total income received during the bienniums of 1936 and 1937 even though the exemption of food products was in effect during this period. This is added proof that the sales tax is well administered.

Provided that no additional exemptions are enacted by the Legislation, this source of revenue will continue to yield sufficient funds required by the state to support the costs of public education. If business improves, the sales tax can be depended upon for additional revenue which can be used for financing the ever increasing requirements of social welfare work.

Administration of the Tax

Much has been said favorable to the board which administers this tax. The chief administrative body is the State Board of Equalization whose duties are so many that they exercise only limited authority over administration. Probably the most important unit in the administration of the tax is the field audit force. The high yield and effective administration have been largely a result of the organization of a program of field audits

[1] The use tax is a compensatory tax on the privilege of using personal property which has been purchased at retail outside the state. It is a device resorted to in an effort to restore business diverted by the sales tax, to normal intrastate channels and by so doing to check the loss of revenue from the sales tax. The validity of the use tax was upheld by the Supreme Court on March 29, 1937 upon the ground that the tax is not upon the operation of interstate commerce but upon the privilege of use after commerce has come to an end.

[2] Statistics in this section are from the Biennial Report of the State Board of Equalization, Sacramento, California. (1938)

and investigations. The moderate increase in the appropriation for sales tax administration was used to expand this force and this expenditure has more than proven its worth because more field audits have been made during 1937 and 1938 and a greater amount of additional revenue from assessments has been collected. The following table gives a comparison of audit costs and additional assessments for 1937 and 1938.

TABLE 2

TABLE SHOWING INCREASED ASSESSMENTS MADE BY FIELD AUDIT FORCE

CALIFORNIA 1937 - 1938

Year	Expense	Audits	Additional Assessments
1937	544,638	28,563	3,072,819
1938	650,836	27,809	3,307,396[3]

The value of the field audit force can not be measured merely by the amount of additional assessments that it can make. The results are clearly reflected also in increased yield through the larger number of correct returns filed by retailers who have been audited and shown their errors. The general knowledge that there are field auditors is a healthful deterrent to any attempts at evasion. The field audit staff instructs taxpayers in proper methods that avoid costly errors, and by stamping out evasion which results in unfair competition upon those who pay the tax. The taxpayer files his return quarterly. The only check made on him is the occasional visit by a member of the field audit force, yet this is sufficient to guarantee proper tax reports.

To summarize this tax it is safe to say that it has proven a life

[3] Biennial Report of State Board of Equalization, Sacramento, California,1938

saver to a nearly bankrupt California and in spite of any defects that it may possess, it has more than lived up to the expectations of it's proponents.

The Mississippi Sales Tax

Mississippi was the first state to levy a retail sales tax at a substantial rate. Sales taxes were used in this state as early as 1815 and continued through the Civil War period until it was replaced by the general property tax in 1870. In June of 1930 Mississippi again made use of the sales tax but due to the privilege tax offset[4] and other exemptions under this act the tax collections were insignificant. Only $218,039. was realized during the last seven months of 1930 and the first nine months of 1931[5] and late in this year it became apparent that the sales tax was of little avail in reducing the state deficit which had mounted to nearly $8,000,000.

The old tax law was repealed and in April of 1932 a heavier and broader multiple-stage sales tax was put into effect. Rate increases under the new law varied from one hundred to seven hundred per cent as shown by the following table.

[4]Taxpayers were allowed to set off any privilege taxes paid by them against sales taxes due.

[5]A.S. Coody, Secretary, State Tax Commission, Statistical Sheet No. 5, Jackson, Mississippi.

TABLE 3

COMPARATIVE RATES UNDER MISSISSIPPI'S SALES TAX LAW

1930 and 1932

Class of Business	Rate 1930	Rate 1932	Per cent Increase
Producers			
a. Oil, Timber, Minerals	1	2	100
b. Natural Gas	1	2.5	150
Retailers			
a. Automobiles	0.25	1.00	300
b. Chain Stores(5 units or more)	0.50	2.00	300
c. All other	0.25	2.00	700
Public Utilities			
a. Water Works and Sewerage	0.5	2.0	300
b. Street Railway	0.5	2.0	300
Contractors	0.25	2.0	700
All other business	0.25	2.0	700

Source: General Laws, 1930, Ch. 90; 1932, Ch. 90.

Collection of the Tax

In California, the sales tax was collected by the retailer who charged an extra cent for purchases of fifteen cents and on a graduated scale equal to two per cent of the sale. After July 1, 1936 Mississippi made use of sales tax tokens as a medium of collecting the tax. The State Tax Commission in a letter to the merchants of Mississippi said in part: "On July 1st we expect to be in a position to supply to the banks, and through them to the merchants, a sufficient quantity of sales tax tokens to make

possible a full compliance with the mandatory provisions of the act passed by the recent session of the Legislature, requiring the collection of the sales tax by merchants and others from purchasers. This act was passed by the Legislature at the direct instance of a number of Mississippi merchants. H.B. 597 was in no sense a Tax Commission Bill, but it is the duty of the Commission to see that its provisions are made effective.[6]

The Commission adopted the sales tax token as a means of administering the sales tax law which requires that vendors collect from the purchaser the sales tax levied by Chapter 119, Laws of 1934, as amended. The tokens are of two denominations, the aluminum marked "1" and the brass marked "5". They are labeled as follows: On one side, "Tax Commission, Mississippi, Sales Tax Token", and on the reverse side, "To Make Change for Correct Sales Tax Payment". The aluminum token marked "1" will pay a tax equal to 1/10th of a cent or one mil. The brass token marked "5" represents the payment of the tax in the amount equal to one-half cent or five mills.

All money received from the sale of tokens will be set aside by the Commission in a special fund to guarantee redemption, at face value, of all tokens in circulation. Then, if a merchant accumulates more tokens than he can dispose of, he may wrap them and turn them in for cash at the office of the State Tax Commissioner.

It was specified in the tax law that tokens were to be used in case of cash sales only and prepared a schedule for the proper manner of collecting the tax.

[6]Mississippi Mandatory Sales Tax Law of 1936. H.B. No. 597 Rules and Regulations. Sales Tax Tokens - Issued by Miss. Tax Comm. Jackson, Miss.

TABLE 4

TABLE SHOWING AMOUNT OF TAX ON SPECIFIC AMOUNTS IN MISSISSIPPI

Cash Sales Involving

4¢ to 9¢	inclusive	one "1" token
10¢ to 14¢	"	two "1" "
15¢ to 19¢	"	three "1" "
20¢ to 24¢	"	four "1" "
25¢ to 29¢	"	one "5" "
30¢ to 34¢	"	one "5" and one "1" or 6 "1"
35¢ to 39¢	"	one "5" and two "1" tokens
40¢ to 44¢	"	one "5" and three "1" "
45¢ to 49¢	"	one "5" and four "1" "
50¢ to 54¢	"	one cent

55¢ and up - Same ratio as above shall apply

Source: Mississippi Mandatory Sales Tax Law of 1936 - Rules and Regulations Sales Tax Tokens, Issued by Miss. State Tax Commission, Jackson, Mississippi, July 1, 1936.

In the case of charge account sales the tax will be computed by the vendor on the basis of two per cent of the total amount of the charge sales at the end of each week or month when the account is paid.

Importance of the Tax

The sales tax has become a vital part of the Mississippi fiscal system, combining, as it does, a broad method of business taxation with taxation of consumption expenditure. Exclusive of receipts from borrowing, sales tax receipts comprised 16.1 per cent of total state receipts in the calendar year 1935 and 16.9 per cent in the calendar year 1936. Excluding federal aid, gasoline, auto license revenue, and other special fund receipts, they

furnished over one-third of state revenues available for general fund purposes. Revenues were quick to respond to growing business volumes, to the heavier rates and the broader base of the 1932 Act. For years ending April 30th, sales tax collections coming into the State Treasury, including the one dollar license fees, were 2.3 millions in 1933, 3.1 millions in 1934, 3.9 millions in 1935, and 4.2 millions in 1936.[7]

The West Virginia Gross Sales Tax

Purpose of the Tax

The West Virginia Gross Sales Tax, first effective in 1921, has the distinction of being the first comprehensive and fiscally important sales tax in the United States. In a broad sense it was a by-product of the intensive agitation for a federal sales tax during 1920-1921. More cogent explanations of its origin were efforts to remove from property part of the increasing cost of state government and to tax more heavily the "depletion" of natural resources. West Virginia is rich in coal, petroleum, timber, natural gas, and other resources, which in the main are shipped outside the state after severance. Following the World War, when state expenditures rose to new high levels, there was a strong popular movement to make natural resource industries bear a greater share of the cost of government. In 1919 the Legislature imposed a pipe line tax with respect to transportation of petroleum, its products, and natural gas. Litigation ensued, and, as a result, the Act was held invalid by the United States Supreme Court on the grounds of violating the interstate commerce clause.[8]

[7]Neil H. Jacoby, Retail Sales Taxation, Pages 65 & 66

[8]Eureka Pipe Line Co. v. Hallanan, 257 265 (1921)

Failure of the pipe line tax to produce the $1,500,000 annual income predicted by its proponents aggravated the financial difficulties of the state. At its regular session in 1921, the Legislature considered bills contemplating heavy taxation of the production of coal, oil, natural gas, and timber -- legislation that was vigorously opposed by producers. A broader sales tax encompassing nearly all business activity was subsequently introduced as a compromise. Fearing a deadlock, the Governor threw his support to the latter bill, which became law on July 1, 1921.[9]

The Tax in Operation

The Gross Sales Tax Act applied at various rates to nearly all types of business activity. (See Table 5). The rate levied against the extractive industries was double that levied against any other. Due to the various exemptions, the sales tax failed by one or two millions to produce the expected revenue during its first year of operation. The tax did not live up to expectations, but it continued in operation until 1925 when it was repealed and a new Business and Occupation tax was introduced carrying a different and heavier rate structure. This change allowed the Legislature to reapportion the tax load and vary rates as it desired. (See Table 5)

[9] Neil H. Jacoby, Retail Sales Taxation, Pages 52-53

TABLE 5

COMPARATIVE RATES UNDER THE WEST VIRGINIA SALES TAX LAWS

1921 - 1925 - 1933

Class of Business	Rates 1921	Rates 1925	Per Cent Increase	Rates 1933	Increase 1933-1925
Producers -					
Coal	0.40	0.42	5.0	1.0	138.0
Oil	0.40	1.00	150.0	3.00	200.0
Gas	0.40	1.85	362.5	6.00	224.0
Sand, Gravel	0.40	0.45	12.5	3.00	566.0
Retailers (Gross Income	0.20	0.20	0.0	0.75	275.0
Public Utilities					
Water (ex. mun.)	0.20	0.40	100.0	4.0	900.0
Natural Gas	0.20	0.40	100.0	2.0	400.0
Contractors	0.20	0.30	50.0	2.0	567.0

Source: West Virginia Acts 1921, Chap. 110; 1925 Ex. Session Chap. 1, 1933 1st Ex. Session, Chap. 33.

Even though there was a $10,000 annual exemption, collection procedure was so strengthened that the tax became much more remunerative than its predecessors.

The sales tax continued unchanged for eight years until May 27, 1933 when, as a result of the business depression, it became necessary to raise the rates to furnish additional revenue for the state's treasury. A surtax was added by the Legislature along with a new General Consumers Sales Tax. The surtax was an additional levy equal to one-half the normal tax rates on all classes of business with the exception of contractors, banks, water companies and retailers. The General Consumers Sales Tax taxed

tangible personal property and certain services rendered to consumers at two per cent.

This represents, in substance, West Virginia's Sales Tax. First, the Gross Income Tax, a levy upon the retailer, who makes quarterly returns to the Commission and the Consumers Sales Tax collected by the retailer from the consumer. The sales tax is an extremely important part of the states revenue system. (See Table 6). It is doubtful if any state has put such reliance on this single source of revenue as has West Virginia.

TABLE 6

RELATION OF SALES TAX TO TOTAL REVENUE COLLECTED
WEST VIRGINIA, 1922 - 1936*

	Sales Tax Revenue				
Year	Gross Income Tax	Consumer's Sales Tax	Total	Total Revenue Collected	Per cent Sales Tax to Total
1922	$ 1,462			$ 2,219	65.9
1923	2,708			3,569	75.9
1924	3,056			4,811	63.5
1925	2,551			4,891	52.1
1926	3,159			6,775	46.6
1927	4,076			8,589	47.5
1928	3,805			8,901	42.7
1929	3,657			9,739	37.5
1930	3,705			10,104	36.7
1931	3,065			10,273	29.8
1932	2,328			8,762	26.6
1933	1,605			7,707	20.8
1934	8,619	$1,769	$10,388	17,900	58.0
1935	12,950	6,836	19,785	28,495	69.4
1936	12,335	7,612	19,947	29,511	67.6

*In Thousands of Dollars

Source: State Tax Commissioner, 16th Biennial Report, Chap. VIII.

Outstanding as the sales tax may be to the state fiscal system, retail sales have produced but twenty-three per cent of the total revenue. This means that nearly eighty per cent of the tax is paid by other groups than the consumer, an excellent feature for any sales tax. West Virginia's Sales Tax is borne primarily by the industrial groups of the state and due

to this (See Table 7) it constitutes a heavy burden above those imposed by other states on similar activity which may have the effect of keeping industries from establishing themselves within the state or force them to move from the state.

TABLE 7

DISTRIBUTION OF SALES TAX ACCORDING TO BUSINESS

WEST VIRGINIA - 1936

Business	Collections	Per cent to Total
Production	$ 3,644,304	29.5
Manufacturing	1,305,330	10.6
Wholesale sales	288,713	2.3
Retail Sales	1,388,993	10.9
Banks and Public Utilities	5,037,444	40.8
Amusements	48,410	0.4
Contractors	203,996	1.7
Other Business	467,525	3.8
Total	$12,334,714	100.0

Source: Tax Commission of West Virginia, 16th Biennial Report

The Nature of the Tax

To summarize, West Virginia has worked her tax out over a long period of time and has applied it primarily to extractive industries for a threefold purpose. First, to protect her natural resources from exploitation; secondly, to provide her treasury with much needed revenue; thirdly, to keep this so-called "unequal" tax away from the consumer, who is least able to pay, and apply it to industry which can more easily absorb the burden. West

Virginia, through the application of relatively high rates, has been able to keep administration costs down to one or two per cent of the total collected from sales taxation.

The Use Tax

One characteristic of the American people is their inherent desire for freedom. That freedom applies not only to religion or the press, but to every activity that man performs. Our government tends to restrict that freedom in many ways. We accept many restrictions because they are for the benefit of society as a whole. Taxation is a form of restriction placed upon our freedom. No one likes to pay taxes and many of us will go out of our way to avoid payment of them. When first introduced to twentieth century finance, the sales tax was commonly called a "nuisance tax". People not only disliked the tax because it took part of their savings but because it involved extra time and extra work on their part to pay the tax. For these reasons a large group of persons dwelling in sales tax states sought to avoid payment of the tax. It was easy enough to do this, simply purchase goods covered by the sales tax in a state that did not employ this type of taxation. At first there seemed to be no objection to a person going out of state to buy goods but within a short period of time the movement had obtained such great proportions that it became necessary to do something to curtail it.

Purpose of Tax

Legislatures in many states immediately passed laws for a use tax, a compensatory tax on the privilege of using personal property which has been purchased at retail outside the state. It is a device resorted to in an effort to restore business diverted by the sales tax to normal intra-

state channels and by so doing to check the loss of revenue from the sales tax.

A History of the Tax

The use tax was not first employed as a supplementary measure to the retail sales tax, but was originally used on a broad scale in connection with gasoline taxes. Many states have levied taxes on gasoline "withdrawn" from a state or "used" in a state in order to circumvent avoidance of taxes laid only on sales. The United States Supreme Court not only upheld the principle of use taxation prior to its employment in conjunction with retail sales taxes[10] but validated state gasoline tax acts making use of it.

The recent state sales taxes merely represent a generalized application of a familiar principle, and the Court was being entirely consistent with its early pronouncements when it upheld general use taxes early in 1937.[11] However, it appears probable that property brought into a state and definitely allocated for subsequent use in the operations of interstate commerce may remain outside the scope of state use taxes.[12]

Following the decisions of the Supreme Court in 1937, use taxes were, with one exception, in operation in every state that had sales tax laws. The motivating force behind the use tax in nearly every instance has been the desire to extend protection to retailers against the untaxed competition

[10] In Nashville, C and St. L. Ry. Co. vs. Wallace, 288 U.S. 249 (1933). The Court said that states might lay excise taxes upon the exercise of any of the constituent elements that constitute the right of property in a thing, except the right to use it in interstate commerce.

[11] Henneford et al vs. Silas Mason Co. Inc. et al, Supreme Court 1937. Court upheld the tax as being upon the privilege of use after commerce ended not upon interstate commerce.

[12] Neil H. Jacoby, Retail Sales Taxation, Pages 147-148

of competitors in other states and they have provided at least a partial answer to the complaints of home merchants that their customers can buy tax-free in other states.

Use taxes in all states are similar in legal form, being imposed on the privilege of "using, storing, or consuming" tangible personal property in a state, and in some states upon the privilege of using the property alone. The base of the tax is the same as the retail sales tax and those items usually exempt from sales taxation are also exempt by the use tax laws. Most states permit a non-resident to use his personal property for non-business purposes tax free, and other states probably overlook it in practice. This appears to involve recognition of the fact that travelers or tourists did not buy the property they brought into a state with the purpose of avoiding tax.[13]

An Evaluation of the Tax

It would be hard to evaluate the use tax unless it were in conjunction with the retail sales tax. While experience is relatively short, it appears that the use tax has been partially, at the last, effective in accomplishing its purpose, both by taxing transactions escaping retail sales taxation, and reducing purchases made outside the state to avoid the tax. On the other side, use taxes have two main defects, incomplete collection and discrimination against trade between the states. One cannot commend tax legislation that can be ignored by wide groups of taxpayers, for it tends to undermine respect for tax laws in general.[14]

In addition, it is a bad policy for one state to set up virtual import

[13] Neil H. Jacoby, Retail Sales Taxation, Page 150
[14] Neil H. Jacoby, Retail Sales Taxation, Page 157

duties that affect a consumer trading in his customary channels. It would be possible to partially rectify the first defect if exemptions of the use of property of a stipulated value were made each month or each quarter year. The use tax would become far less objectionable also if reciprocal laws were made to exempt property from taxation upon which taxes of other states have been paid. It is the opinion of some authors that the fact that states have been compelled to resort to use taxes in order to make the retail sales tax acceptable, should be charged up against the latter as a major defect.

The New York City Sales Tax

The New York City Sales Tax was first enacted in 1934, pursuant to enabling legislation granted the City by the State of New York. The first effective date of the Sales Tax was December 10, 1934. The enabling legislation has been renewed annually since that time and there has been no lapse in the imposition of a City Sales Tax during the period from 1934 to date.

Purpose of the Tax

The purpose of the Sales Tax Law was to raise funds to relieve the sufferings and hardships caused by unemployment. All of the revenue realized from this source is specifically earmarked and used for the purpose named. The Sales Tax Law is only one of five Emergency Tax Laws presently in effect in New York City. The others are the Compensating Use Tax, The Utility Tax, the Gross Receipts Tax and the Conduit Tax. The revenue from all of these Emergency Taxes is earmarked in the same manner as that derived from the Sales Tax.

The Tax in Operation

All vendors of tangible personal property[15] in the City of New York are required to register with the Emergency Revenue Division and are called upon to file returns on all sales made by them within the taxable periods provided in the local laws, even though there may be no tax due upon such sales.

This department has a large audit staff which audits the taxpayers regularly; deficiency assessments are issued against such taxpayer if the same are found to be proper; provisions are provided in the Sales Tax Law for hearings before the Comptroller on the deficiency assessments; power is given to issue warrants, to levy and execute upon the property of taxpayers who have failed to pay tax assessments or who are delinquent in their normal returns; investigative units have been set up to take care of all complaints of tax evasion and tax avoiders and generally all steps are taken to properly and promptly secure the City of New York the ultimate revenue from the Emergency Taxes. The percentage cost of administration in proportion to the revenue received is exceedingly low.

The revenue received from the Sales Tax at this time approximates

[15]The words "tangible personal property" mean corporeal personal property of any nature. This includes all property which is movable and has substance and intrinsic value or worth. It includes such things as gasoline, oil, jewelry, furniture, machinery, clothing and other articles of apparel, livestock, vehicles of all kinds, ranges, building materials of all kinds, moving picture films, etc. If the property when sold is personal property but is subsequently annexed to and becomes part of the realty to which it is attached it nevertheless is subject to the tax.

The term "tangible personal property" does not include land, buildings, or other improvements already erected upon land or which have become permanently affixed and are part thereof. These are real property. The tax is not imposed upon rents derived from real property. Vendors of gas, electricity, steam, etc. are subject to the tax laws.

$50,000,000. This result justifies the imposition for without it, in order to meet the heavy demands made upon the city administration for the care of the poor and needy, there would have been required considerable borrowing by the City, which would result in a decided increase in the general city taxes.

Imposition of the Tax

The law imposes a tax of two (2%) per centum or three (3%) per centum on the amount of the receipts from every taxable sale in the city of New York. The law provides that the vendor in collecting the tax from the purchaser acts as trustee for and on account of the City of New York. Officers of a corporate vendor are personally liable for the tax collected or required to be collected by such corporation. Tax collections in the possession of the vendor constitute a trust fund and must be kept separate from all other funds of such vendor. It has been suggested by the comptroller that vendors maintain a separate bank account for tax collections.

The two per cent tax applies to the sale of tangible personal property sold at retail with the following exceptions:

1. Cereals and cereal products
2. Milk and milk products, other than candy and confectionery
3. Meat and meat products
4. Fish and fish products
5. Eggs and egg products
6. Vegetable and vegetable products
7. Fruits, spices, and salt
8. Sugar and sugar products other than candy and confectionery

9. Coffee and coffee substitutes

10. Beer or other similar malt beverages

11. Tea, cocoa and cocoa products

12. Water, when delivered through mains and pipes, not bottled water

13. Drugs and medicines sold upon a physician's prescription

14. Newspapers and periodicals

15. Cigarettes, except as otherwise provided for by law

The three per cent tax applies to the sale of gas, electricity, refrigeration, steam, whether used for domestic or commercial use. The receipts from every sale of telephony and telegraphy or telephone or telegraph service are also included in this group. This tax also applies to the receipts from every sale of food and/or drink of any nature in restaurants, cafes, bars, and other establishments, including in the amount of such receipts any cover, minimum, entertainment or other charge made to patrons where the charge to the patron is one dollar or more. Also included in this group are wines and liquors and other alcoholic beverages, and drinks composed thereof or otherwise, whether sold for consumption off or on the premises; provided however that sales of beer or other similar malt beverages shall not be taxed except as provided in the previous paragraph.

Tax payments must be made quarterly unless receipts are so small that this method would be impracticable.

The New York City Sales Tax has been in operation for over six years and has proved to be a life saver to New York's finances. The base for the tax has been designed to relieve the burden from those who are unable to share in the unemployment relief costs and for this reason it is much more

equitable than many sales tax systems.

CHAPTER III

INCIDENCE OF THE SALES TAX

The Sales Tax and the Land Tax

State officials in an attempt to adopt sales tax systems in their states will, without a doubt, express the possibilities of reducing real estate taxation through the application of a retail sales tax. Ordinarily it would be possible to lower one type of tax if there was an offsetting increase in some other source of revenue. Therefore the question boils down to whether or not a retail sales tax would provide sufficient revenue to offset the reduction proposed under real estate taxation. One other element that enters the picture even though it has no direct bearing upon the sales tax arises when we ask ourselves this question: "How do we know that the Sales Tax will be used to lower our real estate tax?" The answer is "We don't". Many times in the past taxes have been passed for a specific purpose yet before long the revenue from that particular tax becomes just another part of the total revenue and is spent just as any other income. Gasoline taxes at one time were levied to provide revenue to build roads. For a short time this revenue was used in part for this purpose, but today, the gasoline tax in practice is just another source of state revenue.

Effect of the Tax on Home Owners

Let us suppose that the additional revenue, if collected, will be applied to reduce real estate taxes and see what the result will be. The first question that arises is: "How much would a home owner save on his real estate tax and how much would he pay on a sales tax if the latter were used to offset some of the former?" It should be borne in mind that there

is no possibility that a general sales tax could be used to replace the total state and local taxes on real estate. Even a tax as high as two or three per cent would probably offset only a few mills of the real estate tax. The home owner, therefore, in looking to the sales tax for relief must compare it with the equivalent amount of real estate tax which it would offset, and not with the total property levy.

A few simple calculations will give an approximate idea of the relative burden of these two taxes upon different groups, although exact relationships will vary from one state to another due to the different factors involved.

It was estimated by groups advocating a general sales tax in the state of Maine in 1934 that a two per cent tax on retail sales, including foods, would yield approximately $4,000,000 in that state. It was also estimated by these groups that every additional $650,000 of new tax money would be sufficient to offset one mill of the property tax. Therefore, it appears that the two per cent sales tax would be approximately equivalent in yield to a six mill property tax.

For purposes of illustration in estimating how substitution of a general sales tax for part of the real estate would affect home owners, let us imagine six home owners, A, B, C, D, E, and F, with varying property values and incomes that seem to be of a fairly typical nature, as indicated in Table 8.

Probably the great bulk of home owners in Maine, as in other states, are in the A, B, and C groups. Certainly most of those in danger of losing their homes because of taxes would be found in these groups.

According to statements by various authorities it appears that real

estate assessments in Maine are not more and probably somewhat less than fifty per cent of full value. Let us assume that the average rate of assessment is fifty per cent of its full value.

TABLE 8

TABLE SHOWING HOW THE SALES TAX WOULD RELIEVE REAL ESTATE TAXES

Tax Payer	Value of Real Estate	Annual Income	Saved on 6 Mill Reduction*	Spent on 2% Sales Tax **
A	$ 2,000	1,000	6.00	12.18
B	4,000	2,000	12.00	23.44
C	6,000	3,000	18.00	29.64
D	10,000	5,000	30.00	42.90
E	25,000	10,000	75.00	78.60
F	50,000	15,000	150.00	95.10

*Assessment at 50% of full value.
**See Table 9

Source: Robert R. Doane, Business Week, 1932

The table indicates how much each type of home owner would save under a six mill reduction and how much each type of home owner would have to pay under a two per cent tax on retail sales.

From this table we see that the sales tax offers no relief whatever to the small home owner but increases his burden instead. Taxpayers with homes valued at two thousand to four thousand dollars and with incomes ranging from one to two thousand dollars find that they would have to pay on the sales tax about twice as much as they saved on the real estate tax. It is not until we reach the owners of property valued at over $25,000 that the sales tax relieves property and these are the groups of property owners

for whom relief is not so necessary, as it is universally recognized that large properties are under-assessed in relation to small ones. An equal assessment basis would only add force to the figures in the above chart.

The home owners sales tax is paid out of the same pocket from which his property tax is paid. It is difficult to see how tax sales can be avoided by means of a sales tax which makes the home owner pay twenty-four dollars in order to save twelve dollars. If it is the lump sum nature of the real estate tax that makes it so burdensome, then more genuine relief may be afforded the home owner by establishing a system of installment payments, either in monthly or quarterly periods, that would allow him to spread the burden of the tax over a longer period of time.

TABLE 9

TABLE SHOWING APPROXIMATE AMOUNT PER $1,000 OF INCOME WHICH A GENERAL SALES TAX TAKES FROM DIFFERENT INCOME GROUPS

Income	Amount Taken by 2% Tax	Amount Taken by 3% Tax
$1,000 and under	$12.18	$18.27
1,000 under 2,000	11.72	17.58
2,000 " 3,000	9.88	14.82
3,000 " 5,000	8.58	12.87
5,000 " 10,000	7.86	11.79
10,000 " 25,000	6.34	9.51
25,000 " 50,000	4.44	6.66
50,000 " 100,000	3.68	5.52
100,000 " 150,000	3.10	4.65
150,000 " 300,000	2.42	3.63
300,000 " 500,000	.84	1.26
500,000 " 1,000,000	.50	.75
1,000,000 and over	.20	.30

Source: Business Week, 1932

It must be borne in mind, of course, that the amount of property tax which a two per cent sales tax offsets will vary somewhat in the different states. It appears likely, however, that in any state the general results

will be much the same. That is, the small home owner will lose by the imposition of a general sales tax, the large real estate owner will gain, and holders of property at some intermediate stage will find that their tax costs are approximately equal under either system.

In an address before the National Municipal League on June 10, 1934, Professor Mabel Newcomer, in discussing the two per cent sales tax proposed for New York State said: "It is apparent that in general real estate owners will benefit at the expense of others, since it is not ordinarily possible to shift the full burden of real estate tax in rent. What is not so apparent, however, is that the small home owner stands to lose along with the renter, the added price which he pays for his daily purchases being greater than the reduction in his real estate taxes. The best estimates that I can make indicate that the net addition to taxes paid by the small home owner with a one thousand dollar income in this state would be six or seven dollars if the proposed two per cent sales tax were substituted for ten or twelve per cent of the real estate tax. On the other hand, the man with a ten thousand dollar income and his own home would just about break even, and the man with a one hundred thousand dollar income would have his tax bill reduced by about two hundred dollars. Thus, it is apparent that the small income families, even those who are home owners, stand to lose by such a change."

There seems to be a striking similarity between the estimates made in Maine and those made in New York State which should give added weight to the veracity of each estimate. To apply the sales tax to lighten the burden on real estate is to penalize the poor man and assist the wealthy.

The Sales Tax and Business

The simplifying assumption has been made that the burden of the sales

tax is borne wholly by consumers of taxed goods and services. No elaborate demonstration is needed to show that this is not always true. Sales taxes may impose burdens upon persons in other capacities than as consumers, and in amounts less or even greater than the amount of taxation of particular transactions; and a burden borne at one period following imposition of a sales tax is often thrust backward or forward to some other party after the lapse of time. Determination of where a tax burden rests presents one of the most complex problems of applied economics, yet it is necessary to have some reasonably satisfactory conclusion evolved lest we evade the purpose of this study of taxation.

Effect of Tax on Marginal Producer

The usual theory is that the sales tax is passed on to the consumer, and generally speaking this is true in the long run. However, this shifting of the burden is by no means uniform, neither is it universally applied. The period during which the tax is to be shifted often requires a relatively long period of time during which business men may suffer heavy losses. Only in the case of commodities for which there is an inelastic demand can the tax be fully and immediately added to the selling price. Otherwise, the slackening of demand due to the added price will result in loss to the seller. An attempt on the part of concerns with a large margin of profit to bear the tax themselves rather than to add it to the selling price will have the effect of forcing into bankruptcy the marginal competitor who at present is just about able to break even.

Sales Tax and Profits

The tax is further discriminatory in that it makes no allowance for profits. The store with a wide margin per transaction and a small inven-

tory turnover would pay the same rate as one with a narrow margin of profit per transaction and a rapid inventory turnover. Since the tax is based on total sales, the tax paid by the store with a frequent inventory turnover would be much larger than that paid by the store with a small turnover even though the margin of profit might be much lower.

The following table has been prepared to show the effect that a two per cent sales tax would have on certain types of business enterprises.

TABLE 10

TABLE SHOWING EFFECT OF SALES TAX ON DIFFERENT TYPES OF BUSINESS

Type of Business	Sales	Expenses	Normal Profit	2% Sales Tax	Profit Less Tax
A. Non-competitive	$ 50,000	$ 25,000	$25,000	$ 1,000	$ 24,000
B. Specialty goods	10,000	6,000	4,000	200	3,800
C. Foodstuffs	1,250,000	1,200,000	50,000	25,000	25,000
D. Highly Compet.	2,500,000	2,450,000	50,000	50,000	
E. Dept. Store	2,600,000	2,550,000	50,000	52,000	(2,000)
F. Newly Organized	100,000	100,000	------	2,000	(2,000)

Source: Compiled by Author.

Stores and manufacturing establishments with heavy operating expenses and large indebtedness would be at a particular disadvantage. Numerous industries (F) just about able to break even would not be able to stand up for any length of time under the additional load of the tax. They would not be given an adequate opportunity to pass the burden along to the consumer by means of raising prices, reducing quality or some other device.

The great injustice of the tax is that it falls upon the concern making no profit (F) just as hard, if not harder, than upon the concern that has a

large profit ratio (A or B). To the extent that the tax is not shifted, it must be paid out of profits. If there are no profits, the tax might force the marginal firm out of existence. A business making no profit at all cannot continue to pay the tax and still exist.

Mr. Alfred Buehler, in a recent comprehensive study of general sales taxation, declared that "the uniform application of a gross sales tax to business enterprises, when the tax can not be shifted, involves the most serious inequalities". A witness during the hearing of the West Virginia Tax Commission in 1926 presented data showing how the sales tax collected from one to twenty-five per cent of the net profits of West Virginia business establishments, even though the same rate was applied in each case. Turning back to Table 10 we can easily see that business "A" paid a sales tax equal to four per cent of its profit, business "B" paid five per cent, business "C" paid fifty per cent, business "D" paid one hundred per cent, while business "E" and business "F" had losses for the period as a result of the tax. While these are representative businesses, they do, nevertheless, illustrate the gross injustice of this type of taxation.

If the tax could always be shifted immediately to the consumer, the above discriminations would not matter, but such shifting does not always take place. Even when the burden is passed on, the process of shifting may be delayed so that meanwhile the business concern has to bear the burden. The tax will, therefore, work to the disadvantage of such business men as cannot pass it on, or who are delayed in shifting it, or who in doing so irritate their customers and consequently suffer the loss of trade and good-will. That the latter may readily happen was illustrated by the experience of a Pennsylvania merchant who sent out his monthly bills designating the

cost of merchandise, the sales tax, and showed a total of the two. Much to his amazement, many of his customers deducted the tax from the bill and sent a check for the remainder. The merchant could not very well refuse to accept the check and in this manner was forced to pay the tax from his own pocket.

The Sales Tax and Manufacturers

To go back for a moment, sales taxes are generally levied with the idea that they will be shifted by the taxed manufacturers and merchants to their customers. If such be the theory of this type of taxation, it is difficult to understand why Mississippi and West Virginia, which have levied general sales taxes, should discriminate in their rates between various classes of business enterprise. It is true that the ratio of a wholesaler's net income to his turnover is much smaller than the corresponding ratio for a retailer, so that the same tax on the gross sales of both classes of merchants would bear a higher ratio to the net income of the wholesaler than to the net income of the retailer. But if both wholesaler and retailer are to shift their taxes, of what significance is the ratio of the tax to the net incomes of the taxed concerns? This discrimination of general sales taxes between wholesalers and retailers works no injustice if the tax is actually shifted.

The taxation of manufacturers under general sales taxes is a more serious matter than the discrimination between wholesalers and retailers mentioned above. As previously indicated, in many cases manufacturers are likely to find themselves unable to shift a sales tax. An unshifted tax on gross income, as the sales tax then becomes, is a crushing and unequitable burden. A state general sales tax is an ill-advised method of taxing manu-

facturing enterprises according to a majority of the writers on public finance. For this reason it would seem that Pennsylvania with Mercantile License Tax applying only to wholesale and retail merchants is following a much wiser course than West Virginia and Mississippi, which apply their sales tax to manufacturers as well as merchants.

A minimum exemption in a general sales tax permits small manufacturers and merchants to sell their goods free of tax while their larger competitors endeavor to work the sales tax into their prices. In many lines of business activity large enterprises so dominate the market that the competition of small firms is a matter that can be ignored in price determination. There are some classes of business, however, where small enterprises play such a large part in the market that their costs and taxes are a material factor in determining the market price. In such lines of business, the circumstances that their small competitors are exempt prevents the large firms from freely shifting the sales tax. The larger the exemption, of course, the greater is the possibility that the competition of the exempted firms will prevent the taxed firms from shifting the tax. For example, the $30,000 exemption allowed by Georgia in her sales tax makes it almost certain that no retailer who comes under the tax will be able to shift it.

Burden of Records

There is a further disadvantage to business in connection with the sales tax which is not nearly as burdensome as the inequalities of the tax but is nevertheless an added burden for the business man. The burden of detailed record-keeping and computation of the tax is thrown upon the business enterprise. The exact extent of this added cost and annoyance to business is, of course, impossible to estimate, but the many protests on

this score received from business men in countries where the tax is in effect prove that it is considerable.

Sales Tax and Business Organization

A sales tax has a disrupting effect upon the business structure of a country by tending to eliminate the number of sales and purchases in the process of production and distribution. In other words, it tends to eliminate the middleman, and by so doing it fosters the growth of large multiple-process establishments at the expense of smaller concerns.

A highly integrated concern which carries on all the steps of manufacture from raw material to finished goods would pay only one tax upon its final product. In this way the tax favors the large multiple process concern at the expense of the smaller establishment.

For purposes of illustration let us take two establishments which manufacture automobiles. The Ford Motor Company is probably as highly integrated as any automobile manufacturer and the old Auburn Motor Company is a good example of a small automobile producer. Let us see how the sales tax would effect these two. Ford and its subsidiaries own or have control over nearly every part that goes to make a Ford V-8. Bodies, motors, chassis and all necessary parts are merely transferred from one department to the assembly line so that in the whole operation, there is practically nothing purchased, only transferred within the concern and for that reason there can be no sales taxes applied during production. When Ford sold his car there would be a sales tax applied, let us say two per cent on the sales price of eight hundred dollars. The total tax paid by Ford would be sixteen dollars.

On the other hand, the Auburn Company relies upon outside establish-

ments for a majority of its parts. If they bought the motor from Lycoming at three hundred dollars, they would pay a tax of six dollars; if they bought a body from Fisher for one hundred and fifty dollars there would be a tax of three dollars; other equipment and parts cost three hundred dollars, the tax would be six dollars. Auburn therefore pays fifteen dollars in taxes on each car before it is sold. Competition forces Auburn to sell for eight hundred dollars. Therefore it pays an additional sixteen dollars in taxes, or a total of thirty-one dollars in taxes per car as compared to sixteen dollars paid by the highly integrated concern, a difference of about ninety-four per cent.[1]

In discussing the French turnover tax, Carl S. Shoup in his book "The Sales Tax in France" says: "Probably the most severe indictment to be brought against the tax is its influence in changing methods of business. If not entirely unforeseen, these shifts were certainly not the aim of the legislators who voted the tax, and the disappearance of dealers in favor of commission merchants and brokers, the comparative advantage given to large and highly integrated business units, and other by-products of the tax have been used more than once as argument for its repeal".

Alfred Buehler in his book "General Sales Taxation" has this to say on the subject: "The Canadian Manufacturers' Association criticizes the sales tax of Canada because it encourages more direct marketing through the combination of the manufacturing and wholesaling functions. In other countries similar complaints are voiced concerning the undue emphasis of business combination resulting from the collection of a general sales tax. The tax

[1]This illustration is not intended to be correct, merely illustrative of the effects possible under high integration.

committee of the National Industrial Conference Board, which investigated the West Virginia tax system, found that the gross sales tax unduly favors multi-process organizations and is an unequal factor in competition that discourages the single process organization.

While the influence of the tax in shaping the industrial trend may be exaggerated easily, it is illogical that the influence of the tax on competitive conditions is negligible. The integrating effects of the general sales tax are hidden, silent, pervasive, and dangerous because they are working against the smaller and weaker concerns."

The Sales Tax and Small Sale Establishments

It has been mentioned before that the sales tax has unequal effects on business. It discriminates between types of business, it does not take profits into consideration and when bracket taxes are used further discriminations arise. For example, under the New York law a tax of one cent is levied on sales amounting to from thirteen to sixty-two cents. A one cent tax on a thirteen cent package of cigarettes, however, is not a two per cent tax but almost an eight per cent tax. A large portion of the sales made by small establishments therefore are being taxed at several times the two per cent rate. If, however, sales slips are not kept and checked the vendor can return to the state two per cent of his total sales, whereas the consumers have actually paid in considerably more than that amount as taxes. In this instance the retailer stands to gain by the adoption of a sales tax. Oftentimes, however, the retailer stands to lose by the application of a bracket tax. Under the same New York tax as mentioned before injustice comes to many merchants. The five and ten cent stores in New York sell millions of dollars worth of merchandise each year - a majority of which is

composed of small five and ten cent items which are not included within the tax brackets. Since no tax is collected on five and ten cent items and a two per cent tax is levied by the state on total sales, the retailer stands to lose for all sales under the lower bracket limits. A majority of these sales would be under the bracket limits either because it is a natural tendency for them to be so, or else due to the customers who evade taxation by making several purchases under the tax bracket rather than to make one purchase and be subject to a tax. This is one inequality that will be difficult to remedy unless this type of business is exempt from taxation.

The Sales Tax and Sales

One important factor not yet mentioned is the effect that a sales tax has on sales within a state that employs this tax. In the first place, an increase in mail order buying has almost invariably followed the enactment of sales taxes. So extensive have the mail order business and interstate purchases been as a result of sales tax levies, that several legislatures have petitioned Congress for permission to tax such orders. The California delegation also sponsored a resolution in Congress giving the right to tax interstate sales. Congress of course did not grant such requests. The situation is admirably stated in the sales tax veto message of the late Governor Olsen of Minnesota which says: "The bill is unfair to the average independent merchant. In addition to the added bookkeeping cost imposed upon him, the independent merchant would find himself at an even greater disadvantage than he now is in competing with out-of-state mail order houses. These mail order houses ship their merchandise in interstate commerce and hence such merchandise is not subject to the sales tax. The sales tax increases sales resistance on the part of purchasers. What hurts the

customer, hurts everybody. About sixty per cent of the purchasing power of the people is fixed within rather rigid limits. These people live on rather narrow margins. They save little or nothing. Whatever the sales tax takes from the income of such people, it cuts down their purchasing just that much, lowering their standard of living, even encroaching upon the margin of healthy subsistence in multiplied thousands of instances."

When out of state purchases do not tend to interfere with interstate commerce it is possible to protect local merchants to some extent by the application of the use tax, already discussed. However, it is fairly easy to avoid or get around paying a use tax. It would be necessary to establish border patrol systems between states similar to those patrols that now separate "occupied" from "unoccupied" France to prohibit the entrance into a state of goods purchased outside the state. The situation would be much worse in cities that chose to employ a sales tax due to the natural tendency of people to go out of cities away from the crowds to do part of their purchasing and to the great traffic in and out of any large city. Assuming then, that it is impossible to keep sales from being shifted regardless of use taxes let us answer by illustration the often asked question "Does a retail sales tax affect sales"? The answer to this question may be found in the varying experiences of retailers located in the New York City-Brooklyn trading area as compared to retailers of northern New Jersey.

On December 10, 1935, New York City's retail sales tax had been in effect for one year, while a New Jersey retail sales tax became effective on July 1, 1935 and was repealed October 27 of the same year. According to a preliminary report of the Federal Reserve Bank of New York, department store sales for the first half of December 1934 - 12 shopping days - in

New York and Brooklyn were 13.2 per cent over those for a similar period of 1933. The sales tax became effective on December 10, 1934, and the twenty shopping days before Christmas in that year showed that this earlier increase had declined to 7.5 per cent for the period. Even this downward trend does not show the complete picture, since the first twelve shopping days of December 1934 contained four days when the sales tax was in effect. If it were possible to obtain the figures for the first eight days of December 1934 there is every reason to believe that the increase would have been greater than 13.2 per cent for the first half of the month.

Let us compare these figures with those of the adjacent New Jersey area for the same period. According to Federal Reserve Bank reports, there was an increase of ten per cent in department store sales during the first twelve shopping days of December 1934. The increase for the twenty shopping days before Christmas was 9.1 per cent or a relatively small change as compared to the New York City - Brooklyn area.

A month by month comparison of sales for 1935 reveals the following: January and February showed no variation; March in the New York area dropped fifteen per cent, New Jersey only eight per cent; April and May showed no variation. In June, when New Jersey was confronted with its two per cent tax to become effective on July 1, New Jersey increased seven per cent, New York remained the same. In July, when the New Jersey tax became effective, sales remained the same, New York's increased thirteen per cent, which indicates that some of New Jersey's business must have gone to the New York area. New Jersey sales continued at nine per cent below normal for August, while no change was noted in New York. September showed an increase in both states. During October when the tax was repealed sales increased

one percent in New Jersey and declined two per cent in New York. In November 1935 sales increased nine per cent in New Jersey as compared with an increase of only four per cent in New York. The same situation continued through December, New Jersey's sales declined only four-tenths of one per cent, while sales in the New York area decreased three and one-third per cent.

This period which covers a full year of retail sales taxation in New York City and less than four months of a similar retail sales tax in New Jersey proves that a sales tax tends to drive business from taxable to non-taxable communities. To the extent that use taxes cannot be employed, and this is no small matter, there will be a loss of trade in a taxing community. This can be applied to either state or municipal sales taxes with equal effectiveness at least.

The Sales Tax and The Laborer

It is of little or no concern to the average "man on the street" when business is forced to pay an additional tax. The concensus of opinion is that industry with its resources has the ability to pay the tax, and to a certain extent this may be true. On the other hand, when a tax, to be paid by the consumer, is passed this same disinterested person will immediately become concerned. A tax that hits him as hard as the sales tax is bound to be of importance to him.

Tax Pyramiding -- How It Operates

One of the most objectional features to the sales tax is its tendency to take from the pockets of the taxpayer much more than the government receives. That is, while the product is passing from raw materials into the hands of the ultimate consumer, several sales may be involved, thus imposing

several taxes on the commodity before it reaches the end of its journey. Since the value of the commodity increases as it approaches the customer, the percentage tax adds an ever increasing burden which is compounded with every sale. Proponents of the tax aim to avoid the evil of pyramiding and its incentive to integration by a system of licensing producers and stipulating that a sale shall be taxed only when made to an unlicensed buyer. If this system is used it will not eliminate pyramiding unless the sale is made directly to the consumer of the product, no in-between agency can be used.

Professor Buehler says in this connection: "It is uncertain just how much a general sales tax takes from expenditures in tax payments, and only rough estimates based upon particular conditions are available. The French observers, Allix and Lecercle, have estimated that the French turnover tax at a rate of two per cent adds six per cent to eight per cent to the value of the products. Ex-Minister of Industry Hirsch has estimated that the German turnover tax added ten per cent to twelve per cent to consumers prices when collected at the general rate of 1.5 per cent. It has been estimated that the turnover tax of Hungary, with a rate of two per cent,has sometimes added as much as eighteen per cent to consumers prices. While all such figures are mere guesses, with reference to particular conditions in a certain country, they indicate that the general sales tax is heavy enough to be felt."

A careful study of pyramiding made by Meyer D. Rothschild shows that the two and one-quarter per cent manufacturer's levy proposed in the last session of Congress would have cost the consumer eighty per cent more than the government received on a pair of men's shoes retailing at seven dollars;

forty-five per cent more than the government received on a suit of men's clothing retailing at forty dollars; twenty-two per cent more on a rubber tire retailing at thirty-five dollars and ten cents; seventy-three per cent more on forty-five cent cotton cloth; fifty-five per cent more on taffeta silk; seventy-nine per cent more on heavy service gloves; one hundred and twenty-three per cent more on imported gloves; and thirty-three and one-third per cent more on denim overalls and jackets. The tax would operate in the following way. In the case of the shoe, for example, the manufacturer would sell a pair of shoes to a jobber for three dollars and eighty-eight cents. The two and one-quarter per cent levy on these shoes would net the government $.0873, but when the jobber sold to the retailer he would figure on a twenty per cent profit on the entire cost of the shoes to him, including the tax. There would be an increase of $.0174 in the tax which would be passed on to the retailer. The retailer would add fifty per cent gross profit to the cost, likewise including the tax which had now grown to $.1047, so that the consumer would pay a total tax of $.157 on the shoes, or eighty per cent more than the $.0873 which the government had received. Such a tax, therefore, will tend to "snowball" in proportion to the number of intermediate stages between producer and consumer. The Canadian sales tax is now levied at a rate of six per cent, but it is the claim of Canadian retailers, according to Mr. Rothschild, that prices have increased by ten per cent as a result of the tax.

<u>The Inequality of the Tax</u>

The sales tax completely ignores ability to pay. It resolves itself largely into the question as to whether the main tax burden is to come from incomes that are well above the margin line of healthy subsistence, or from

incomes that are insufficient for healthy existence. It is here that the sales tax violates every cardinal principle of just taxation since income is so unequally distributed in this country.[2] For over one-third of the people it actually becomes a tribute levied against actual existence, since these people are not only already below the margin line of normal living, but such a tax falls upon nearly everything they buy, while only a small per cent of the rich man's income will go into articles subject to the tax. It particularly discriminates against those with the larger families to support since it operates like a per capita tax in this respect.

The Sales Tax and the Farmer

The sales tax shows no discrimination in its effect upon the lower income groups, it treats farmer and laborer alike. Since the farmer's property taxes are practically all local, the sales tax could only place an additional burden upon him by increasing his cost of living. There is another aspect,

[2]One-half of all the families in the United States live on fifteen per cent of the total income, while thirty-six thousand of the wealthiest families, constituting one-tenth of one per cent of the population, receive as much income as eleven and one-half million of the poorer families who constitute forty-two per cent of the entire population.(a)

Further information on this subject is furnished by an address by Franklin D. Roosevelt in which he says: "Just as freedom to farm has ceased, so also the opportunity in business has narrowed. It still is true that men can start small enterprises, trusting to native shrewdness and ability to keep abreast of competitors; but area after area has been preempted altogether by the great corporations and even in the fields which still have no great concerns the small man starts under a handicap.

The unfeeling statistics of the past three decades show that the independent business man is running a losing race. Perhaps he is forced to the wall; perhaps he cannot command credit, perhaps he is "squeezed out", in Mr. Wilson's words, by highly organized corporate competitors, as your corner grocer can tell you.

Recently a careful study was made of the concentration of business in the United States. It showed that our economic life was dominated by some six hundred odd corporations, who controlled two-thirds of American industry. Ten million small business men divide the other third.

More striking still, it appeared that, if the process of concentration

however, of the sales tax in its relation to the farmer which should be taken into account. It is best expressed by J. R. Howard, past president of the American Farm Bureau, when he says: "With regard to the sales tax, let me say that the farmer occupies a unique position. I think it is generally conceded that the sales tax is passed down to the ultimate consumer. The farmer can pass nothing to the ultimate consumer because he buys at one man's price, and sells at another man's price, and being at that disadvantage and not able to pass it on, he bears an unjust burden, and is in a place where I am sure he, as a farmer, will object to the broad extension of the sales tax principle."

This statement defines the position of the farmer exactly. It is an axiom of economic theory that any tax upon the price of commodities must reflect necessarily upon the purchasing price of raw materials. Consumer's demand shrinks with increased prices and when taxes are placed upon transactions of a commodity they invariably react or rebound against the producer in the form of lower market prices for his produce or in reduced demand for his product.

The Regressive Nature of Tax

Retail sales taxes are generally said to be regressive in operation, meaning that the average effective rate of taxation decreases as the tax base increases. It is a matter of common observation that persons with large incomes spend a smaller proportion on consumers' goods, and "save" or

[2] goes on at the same rate, at the end of another century we shall have all American industry controlled by a dozen corporations and run by perhaps a hundred men.

Put plainly we are steering a steady course toward economic oligarchy if we are not already there."

[(a)] America's Capacity to Consume - 1934.

"invest" a larger portion than do persons with small incomes. The four "laws" of consumption from the pioneering researches of Engel date back to 1857. Engel concluded that as family income increased, the proportion spent for food decreased, that spent for clothing remained approximately the same, and that spent for education, health, recreation, and other consumables increased. Within the range of his investigations the percentage of income spent for rent, light, and fuel (i.e. housing) remained constant.[3] A general tax on consumer's expenditure therefore affects a narrowing part of total personal income as income increases; or what amounts to the same thing, the ratio of taxation to total income becomes less as income increases. Differences between amounts of personal income are greater than are differences between personal expenditures on consumers' goods and services. The poor are compelled to spend all (or more than) their income on consumers' goods to provide themselves with basic necessities; the rich are able to withdraw a considerable part of income from the range of consumption taxation. Thus regression occurs in the operation of even a general tax on consumers' expenditures.

State sales taxes today, however, are not general taxes on consumer expenditure so that their regression is necessarily of a different degree. If they did not tax the particular kinds of expenditures entering to a large extent into the budgets of the poor, such as essential foods and clothing, they would be less regressive than a general consumers' expenditure tax. On the contrary, since they fail to tax the kinds of expenditures forming a larger portion of the budgets of the rich than of the poor, such as personal services, travel, or domestic servants, they are more regressive.

[3]Engels' "law" was first published in LePlay's "Les Ouvriers Europeen" (Paris 1888)

The growing portion of intangibles in consumption tends to make taxes, limited to tangible personal property, constantly more regressive in their operation. Perhaps also it explains the tendency of the states to broaden the bases of sales taxes by including a widening range of "services" and other intangibles.

Any measure of regression is necessarily based on knowledge of how people in different economic stations utilize their income. For estimations of the pattern of utilization of income by families of different classes resort is had to the researches of The Brookings Institution and The Business Week.[4] While all data in this field are subject to wide error they may be accepted at their face value for present purposes. There appears in Table 11 a summary distribution of income and of consumer expenditure in the United States in 1929, by income groups. More than eighty-five per cent of the forty-eight million income recipients in 1929 realized an income of two thousand dollars or less in 1929, and spent more in the aggregate on goods and services than they received as current income -- owing to borrowing or extension of consumer credit. Less than one-tenth of one per cent of total income recipients received incomes of fifty thousand dollars or more, but this group apparently accounted for nearly thirty per cent of national savings of some $12,500,000,000 in 1929. Table 11 gives a broad picture of income utilization through a wider range of income-classes than any study has yet developed. Our attention should be centered on the lower income-classes since they are the ones who are heavily hit by the regressive action of the sales tax.

The percentages of aggregate income spent on consumers' goods and services

[4]From a series of articles on the American Consumer Market published by Business Week during July and August, 1932.

TABLE 11

DISTRIBUTION OF INCOME AND CONSUMERS EXPENDITURES BY INCOME GROUPS 1929

Income Group (000 Omitted)	Number of Recipients		Income		Expenditures on Goods & Service		Savings	
	Number	Per Cent	Amount (Millions)	Per Cent	Amount (Millions)	Per Cent	Amount (Millions)	Per Cent
$1,000 and over	50	.001	$ 1,354	1.51	$ 87	.10	$ 1,045	8.33
500 under $1,000	80	.002	764	.85	95	.10	567	4.52
300 " 500	1,000	.003	720	.80	127	.14	518	4.13
150 " 300	5,000	.01	1,267	1.41	523	.58	563	4.49
100 " 150	6,000	.01	911	1.02	481	.53	335	2.67
50 " 100	23,000	.05	1,949	2.18	1,268	1.40	712	5.67
25 " 50	65,000	.13	2,583	2.88	2,002	2.20	969	7.73
10 " 25	260,000	.54	4,791	5.35	4,529	4.98	1,326	10.57
5 " 10	607,000	1.26	4,845	5.41	5,614	6.18	941	7.50
3 " 5	1,875,000	3.89	8,994	10.04	9,205	10.13	1,821	14.52
2 " 3	4,071,000	8.45	11,616	12.97	12,004	13.12	1,455	11.60
1 " 2	22,800,000	47.32	32,985	36.82	35,506	39.07	1,806	14.40
1 and Under	18,466,000	38.33	16,806	18.76	17,633	19.40	485	3.87
Institutions	----------	-----	-----	-----	1,799	1.98	----	----
Totals	48,181,000	100.00	89,585	100.00	90,873	100.00	12,543	100.00

SOURCE: Business Week, August 24, 1932

and saved by different income-classes, computed on a basis of The Brookings Institute data are presented in Table 12. It is evident that the percentage of average income in each income-class spent on goods and services declines as annual income increases. In the last column of Table 12 appear the percentages of a two per cent tax on expenditure to average incomes for each class. This series might well be regarded as an "index of regression" of a two per cent sales tax, for it indicates approximately the variation in the average effective rate of taxation as the base (income) increases. Some other rate than two per cent could as well have been chosen without significant difference in the result.

This table indicates that a sales tax on consumers' expenditure would operate regressively from the lowest income-class. A two per cent tax would take no less than two and one-half per cent of the income of farm families with less than five hundred dollars per annum and 0.59 per cent of that of agricultural families whose incomes fall between nine and ten thousand dollars per year, a rate about one-fifth as high. The steepness of regression of a tax on all consumers' expenditure is apparently less with respect to urban families, since practically all income-classes save a smaller proportion of their incomes than do farm families of similar income, but it must be remembered that a very much smaller fraction of farm families in fact realize income of more than five thousand dollars than do city families. The range is from a rate of 2.15 per cent on the income bracket below one thousand dollars to 1.23 per cent on the bracket of fifteen to twenty thousand dollar incomes, or about one-half as much on the highest incomes as on the lowest.

TABLE 12

REGRESSION IN A GENERAL TAX ON CONSUMERS EXPENDITURES

BASED ON DATA OF THE BROOKINGS INSTITUTE

Income Class (000 Omitted)	Per Cent of Average Income Spent on Food, Home & Living	Saved	Ratio of 2 Per Cent Tax to Total Income
FARM FAMILIES			
$ 0 - 0.5	125.0%	-25.0%	2.50%
0.5 - 1.0	102.7	- 2.7	2.05
1.0 - 1.5	91.9	8.1	1.84
1.5 - 2.0	78.6	21.4	1.57
2.0 - 2.5	70.4	29.6	1.40
2.5 - 3.0	64.1	35.9	1.28
3.0 - 3.5	59.8	40.2	1.19
3.5 - 4.0	55.5	44.5	1.10
4.0 - 4.5	51.5	48.5	1.03
4.5 - 5.0	48.2	51.8	0.96
5.0 - 6.0	43.8	56.2	0.87
6.0 - 7.0	38.7	61.3	0.77
7.0 - 8.0	34.9	65.1	0.69
8.0 - 9.0	32.0	68.0	0.63
9.0 - 10.	29.6	70.4	0.59
NON-FARM FAMILIES			
$ 0 - 1.0	107.9%	- 7.9%	2.15%
1.0 - 1.5	99.2	0.8	1.98
1.5 - 2.0	94.3	5.7	1.88
2.0 - 2.5	91.9	8.1	1.83
2.5 - 3.0	89.7	10.3	1.79
3.0 - 3.5	87.6	12.4	1.75
3.5 - 4.0	86.4	13.6	1.72
4.0 - 4.5	85.4	14.6	1.70
4.5 - 5.0	83.5	16.5	1.67
5.0 - 6.0	81.9	18.1	1.63
6.0 - 7.0	79.6	20.4	1.59
7.0 - 8.0	76.9	23.1	1.53
8.0 - 9.0	73.6	26.4	1.47
9.0 - 10.0	71.3	28.7	1.42
10.0 - 15.0	64.6	35.4	1.29
15.0 - 20.0	61.6	38.4	1.23

SOURCE: America's Capacity to Consume, Page 257

The Sales Tax in Operation

The sales tax is a kind of gross-income tax that falls upon the payer in inverse proportion to income; the less a man earns, the greater the proportion of his income that is taken in a sales tax. Using as a basis statistics on the consumers' market collected by The Business Week, Mabel L. Walker of the General Welfare Tax League has shown that a laborer with an income of one thousand dollars a year spends 60.9 per cent of it for commodities upon which the sales tax falls. The poor find that the only important item in their expenditures that is free from a sales tax is rent.

At the other extreme, a man having an income of one million dollars a year will spend only one per cent of it in taxable purchases. The rich, of course, spend a higher proportion of income for wages and services than the poor. We have heard a great deal recently about soaking the rich; but a tax that soaks the poor 60.9 times as much as the rich is a tax that really soaks.

A tax of one per cent exempting food takes $2.74 from the one thousand dollar laborer and eight cents per thousand dollars of income from the multi-millionaire. But the usual tax is two per cent, and most acts include food, so that the one thousand dollar man will pay twelve dollars and the multi-millionaire twenty cents per thousand. Such a reversal of the ability principle in taxation seems incredible, but when the tax is increased to three per cent, as has been done now in many states, the one thousand dollar man pays $18.20, the man with one million dollars a year pays thirty cents per thousand. For all incomes over three million dollars the tax is negligible; for all incomes under twenty-five hundred dollars it is very important.

A recent study in Business Week[5] shows that eighty-four per cent of the purchases of goods and services in the United States are made by consumers with incomes of less than five thousand dollars, and sixty per cent are made by those receiving less the two thousand dollars per annum. But this group which does sixty per cent of the country's buying is able to do only eighteen per cent of the country's saving. Its total savings are equal to only four per cent of its total expenditure. If these savings were evenly distributed a sales tax which raised prices as much as four per cent would therefore wipe out all the savings of this entire group, if they did not curtail their expenditures. But the savings are not evenly distributed. Probably the great majority of these people earning less than two thousand dollars, who do sixty per cent of the country's buying, have no savings whatsoever. For them, the way out would be to curtail expenditures. Even assuming that the tax would not curtail buying by those receiving more than two thousand dollars (which is, of course, not true) it would still be evident that the slackened consumption on the part of those who do sixty per cent of the buying, would be great enough to force many business houses into bankruptcy.

Sales Tax and Purchasing Power

During the past ten years the American people have suffered from a depression that has become spiritual, or mental, as well as economic. There has been an undercurrent of disillusionment throughout the country today that is probably more devastating than the sorrow and turmoil of the World War. It is enervating because of its futility. Factories are shut down, offices are closed, the burden of government continues to bear upon our

[5] Business Week, April 27, 1932

weary backs with ever increasing pressure, and millions of broken-spirited workmen are helpless while they and their families suffer for the vital necessaries of life. Meanwhile, warehouses are stuffed to the rafters with goods that cannot be sold and money is lying idle for lack of investment.

A few years ago a wave of "Buy Now" movements spread over the country. Buying on a large scale was needed to set industry in motion once more and an attempt was made to start this mass purchasing by means of exhortation. These movements were all failures, the forty-five million poverty stricken could not respond. The millions just above the border line of subsistence dared not spend what they had for fear that they might not be able to replace their savings; those who had the ability to spend did not have the desire to buy.

Following the collapse of the "Buy Now" movements the country was struck by another wave of propaganda which had been threatening for some time. The desirability of increasing purchasing power was largely forgotten and a great movement was started to lay the burden of taxation upon such buying as there was. Budgets must be balanced. Therefore, we soaked the poor rather than to burden industry or the wealthy. Twelve or fifteen million people were out of work; nine million others were on part time; millions of others had suffered repeated pay cuts. Fifteen million people in the country were existing only with the help of charity, without which they would perish. Regardless of these conditions, the advocates of the sales tax contended that these people should be made to feel some governmental responsibility. To make them feel this responsibility, sales taxes were passed which would take as much as twenty dollars from the head of a large family who earns one thousand dollars a year. The general reply to

this statement is that he will not feel it. It will be paid in many small amounts over the year and for that reason it will not be noticed. The laborer himself might not notice the twenty dollars but the ultimate result which can not be concealed is that the laborer has spent twenty dollars less during the year on products of industry. The twenty dollars itself is not important but there are millions of laborers in the same circumstances and twenty dollars times one, two, or even five million is a noticeable amount when purchasing is required for a revival of business.

This consequent diminution of purchasing power which must inevitably follow the enactment of general sales tax laws will, undoubtedly, inflict the major suffering on the poor, but it will cause repercussions throughout the entire economic structure. If buying is needed to stimulate recovery, then obviously any action that tends to slow up such buying as there is, will prolong the depression. Such a result will affect not only the workers and jobless, the retailers and the producers, but will also injure transportation, construction, agriculture and other branches of industry. The country as a whole would suffer from the enactment of a sales tax.

CHAPTER IV

CONCLUSIONS

There are many important issues that pertain to sales taxation that have been omitted from this discussion either because the knowledge that can be applied to analyzing them is too scanty or because they raise complications that cannot be treated in the space available. The effect that the sales tax has on consumption at a time when so called "under-consumption" and "oversaving" are subjects of popular discussion; the effect of the tax in raising relief costs through raising prices; the relations between business initiative and the tax, particularly as regards new firms starting in those lines of business where the percentage profit of sales is habitually low; the cost to which the business firm is put in complying with the law, aside from the amount paid as tax, these and other issues are due for further debate in the years ahead.

The purpose of this paper has not been to establish the idea with the reader that the sales tax is the best type of taxation that can be applied nor to establish the sales tax as a poor tax, a tax that should be abandoned for the good of all. The purpose of this paper has been to present the case of the sales tax, its origin, growth, and the position that it now holds in our state revenue systems. It is from the information thus obtained that the following conclusions have been reached.

General Conclusions

Experience has shown us that the sales tax has usually been adopted as a temporary or emergency measure, taxpayers are promised that the tax will expire at a certain date or it is implied that when the emergency is passed the tax will be repealed. Quite often this emergency has been pro-

longed to the point where it becomes difficult to abandon this source of revenue. In many of our states the sales tax has become a part of their constitution and for this reason can not be abandoned unless this portion of the constitution is repealed. The process of repealing an amendment is so complicated and drawn out that it is nigh to impossible to bring about repeal.

In American states the sales tax is still in an experimental stage. Modern finance has brought complications that cannot be met with nineteenth century fiscal policies. For this reason sales taxes are adopted to state problems and requirements hurriedly and in a trial and error fashion. Many state tax laws so constructed have required many changes (viz. Missouri) and in some instances have been completely rewritten. In addition to the law itself, administrative methods must also be modified in the light of experience, as conditions warrant.

In all probability, public expenditures will continue at a high level and, due to the increasing difficulties of expanding tax revenues in other directions, it is likely that the sales tax will remain as permanent revenues in many states. Detestable as general sales taxes are in the eyes of many economists, they find support among those who wish to avoid heavier income taxation and those who seek to broaden the tax base to reach the masses with new imposts.

Sales taxes present many difficulties from the administrative standpoint. It is not easy to obtain a satisfactory definition of taxable transactions. For example, the word "sale" is construed to mean a multitude of things. Many advocate that all "transactions" are "sales" while others argue to limit the scope of "sales". If evasion of the tax is not

to flourish, the states must carefully and continuously audit the books of vendors (viz. California). Use taxes have been applied with mediocre success in an attempt to wipe out tax evasion on the part of the buying public.

The sales tax is usually shifted to the consumer in the long run, but this shifting is neither complete or perfect. Sellers are punished with a loss of sales and declining profits because of the taxes. Marginal concerns, which are found mainly among the small enterprises, find it difficult or impossible to shift their taxes and are forced out of business unless they can manage to shift their taxes.

A sales tax should not be considered as a substitute for income, inheritance, property, or selected commodity taxes. A Practical sales tax even with its broad base would not provide enough revenue to cause a disappearance of any or all of the above mentioned taxes. Where possible, revenues should be secured from the normal revenue sources and sales taxes should be reserved for emergencies when all other revenues fail. Income taxation, which has fallen from its pinnacle during the depression could be expanded to provide relatively more income. Inheritance taxes could also be extended further. Both of these taxes tend to take more from those who are better able to pay governmental costs rather than from those who are least able to pay these costs as the sales tax does. The revenue possibilities of income, inheritance, and selected commodity taxes should be exhausted before sales taxes are utilized. However, if sales taxes are to be avoided, more suitable revenues must be discovered and employed or expenditures must be limited so that a sales tax will be unnecessary.

The sales tax is a highly controversial tax question. Social, economic, and legal considerations are involved in an evaluation of the sales tax as

a part of the tax system. While it is beyond the scope of this study to attempt an analysis of the general effects of the sales tax, the issues will be somewhat clarified by a concluding listing of the advantages and disadvantages of this type of taxation.

Advantages of the Sales Tax

Some of the advantages that have been claimed for the sales tax are as follows:

1. The sales tax is supposed to be a tax par excellence for business and a tax of easy administration for the government. The experience of those who collect the tax reveals that while the virtues of the tax have been exaggerated to a great extent, this tax does nevertheless offer certain advantages as a part of the fiscal system.
2. The base of a sales tax which is gross sales or gross receipts, is probably more easily defined than the base of a net income tax.
3. A sales tax is spread over many buyers and sellers, permitting large revenues to be collected at a low rate of taxation.
4. The payment of the sales tax may be arranged conveniently for business enterprise, which is the tax collector. If monthly tax payments are not adapted to the convenience of the small taxpayer, quarterly payments may be allowed, as in France, pro rated on the basis of annual sales.

5. "A sales tax adds diversity to the tax system. Since it is a tax on sales in general or on a given class of sales, the burdens of the tax are diffused through the community and spreads over the processes of production and consumption. The tax may be employed to reach enterprise or consumption otherwise not taxed adequately."[1]
6. The sales tax is elastic and productive and it secures some support of government from those who would not pay a net income tax.
7. The sales tax although regressive, may properly be incorporated into a tax system which has progressive features.
8. A committee of the National Tax Association made the following comment concerning the use of the sales tax as an emergency measure: "Of the various expedients that have been proposed, we regard the tax on retail sales as the most eligible. This encounters no constitutional difficulties and fewer difficulties arising from interstate competition than are raised by sales falling upon jobbers and manufacturers........Finally, the tax is advantageous because it is placed at the point nearest to consumption, which is in accordance with sound fiscal policy. Administration is simple and

[1] Alfred G. Buehler, General Sales Taxation, New York, 1932, Pg. 197

inexpensive in the case of all dealers whose business is large enough to require them to make a return of their income either to the Federal or state government, since such returns must always include the figure of gross sales....."[2]

9. "Assuming that a state has applied the ability principles in the fields in which it is feasible, but still requires more revenue in view of its program for education, relief, old age pensions, unemployment insurance and other welfare services, there is no serious objection to providing the funds by a sales tax or other taxes that will be borne in some degree by substantially the whole population."[3]

10. As the tax would be paid and reported by the seller, the collection of such a tax would provide maximum certainty and minimum expense for the government.

11. Because nearly every purchase would be taxed, it would encourage the practice of thrift, thus insuring individual reserves for periods of unemployment, sickness, and old age, and discouraging present-day trends toward socialistic taxes for welfare funds.

[2] National Tax Association - Proceedings - 1933: 414

[3] H. L. Lutz - Public Finance - 1936, 643

Disadvantages of the Sales Tax

Professional students of taxation are in general, opposed to the retail sales tax for the following reasons:

1. The sales tax is an upside down tax based upon inability to resist rather than ability to pay taxes.
2. The sales tax has a regressive effect bearing heavier upon persons with small incomes than upon persons with large incomes.
3. There is little merit in the attempt to counterpoise regression and progression through the use of the sales tax. Income, inheritance and estate taxes represent a small portion of federal, state, and local taxes.
4. The sales tax is a concealed tax and minimizes tax consciousness on the part of the public.
5. To the extent that a sales tax rests on business and is not shifted to consumers, there is unequal business taxation because gross sales bear no normal relation to net profits.
6. The sales tax seems to have gained a wholly unwarranted reputation for simplicity and ease of administration.
7. Local distributors near a state boundary line in a sales-tax state are at a competitive disadvantage with distributors in adjoining states, if the latter do not levy a sales tax. This situation leads to boot-

legging of goods across state borders and to evasion of taxes.

8."As an emergency source of revenue the tax has the undeniable advantage of yielding a certain amount of money quickly; but it is not the only tax possessing this virtue. It should not be difficult for the professional student, though removed from the immediate arena of contest, to sympathize with the actions of legislators and others in many states who have been trapped by constitutional limitations. ....Nevertheless, in the writer's opinion, the sales tax as an emergency form of revenue, and certainly as a permanent part of any state's tax system, marks an unnecessary and backward step in taxation."[4]

[4]Haig and Shoup, Page 108

ABSTRACT OF THESIS

The Sales Tax is nearly as old as Public Finance itself, having been practiced in the days prior to the great Roman Empire. The Romans spread the tax through Europe where it was practiced during the Middle Ages. From Spain the tax spread to France, Germany, England, and finally across the Atlantic to Mexico and the American colonies. The sales tax was met with an indifferent attitude in the colonies and for this reason it was used in only a few instances.

Several attempts have been made by the Federal Government to adopt a sales tax but opposition has been strong enough to turn the tide against such legislation in each instance. It is well to note here that each of the three proposals for a federal sales tax have been made when the country was in a wretched financial condition. The first proposal came during the last years of the Civil War, the second in the early 1920's following the World War, and the third in the early 1930's when we were in the midst of the great depression. Since that time there has been little attention given to a federal sales tax.

Sales taxes have been used in state revenue systems with varying degrees of success for over a century. Pennsylvania, West Virginia, Virginia and Mississippi are still employing sales taxes which are a modified nineteenth century tax. California employs the most successful of all sales tax in use today. California's educational system and other agencies are supported by this single type of taxation.

In order that avoidance of the sales tax may be kept at a minimum, nearly all states that have a sales tax employ the use tax as a means of keeping business within the state. Prior to the adoption of this tax it

was possible for residents of sales tax states to cross the border into a state not using the tax, make their purchases, return, and in this manner avoid the payment of the tax. This practice reached such proportions that it became necessary to pass the use tax law. The use tax law places a tax equal to the sales tax on all merchandise bought outside the state and brought into the state for use or consumption. It is impossible to determine the extent that avoidance has been curtailed, but it seems safe to say that even though avoidance cannot be eliminated by the use tax, it can be reduced to the point where business is not seriously disrupted by out-of-state purchases.

The history and growth of the sales tax are both interesting and important, but they do not provide us with a basis for an evaluation of the tax nearly as well as the effect that a sales tax has upon business and upon us who have to bear the burden.

The greatest burden to taxpayers of the lower income group today is the real estate tax. Sales tax advocates have tried to use the argument that this tax would reduce the real estate tax in an effort to gain the support of the lower income group. An investigation shows that the only real estate owners who would stand to gain by the application of a sales tax are those who own over twenty-five thousand dollars worth of real estate. If there is a need for tax relief, it is certain that relief should not be given to those who earn upwards of ten thousand dollars a year (See Table 8) but to those whose income is two thousand dollars or less. It now seems that this method of reducing real estate tax is without foundation as far as the average wage earner is concerned.

The sales tax has an unusual effect upon business; it places the ad-

ditional burden of the tax upon business enterprises. Usually the tax can be shifted to the consumer but this shifting is by no means uniform or universally applied. The shifting process often requires a relatively long period of time during which business men may suffer heavy losses.

The tax is further discriminatory in that it makes no allowance for profits. Regardless of the margin of profit, the tax rate remains the same. The sales tax is levied at a constant rate, whether the business makes a profit, or sustains a loss. Not only does the tax discriminate in regard to profit but it has an unequal effect upon different types of business organizations. A sales tax has a disrupting effect upon the business structure of a country by tending to reduce the number of sales and purchases in the process of production and distribution. In other words, it tends to eliminate the middleman, and by so doing it fosters the growth of large multiple-process establishments at the expense of smaller concern. A highly integrated concern which carries on all the steps of manufacture from raw material to finished goods would pay only one tax upon its final product. In this way the tax favors the large multiple process establishment at the expense of smaller concerns. The smaller concern would pay a tax upon each purchase that it made, and in this manner have its costs increased over its larger competitors.

The sales tax also tends to drive sales from taxed areas. The use tax has been employed to stop this trend but it is not too effective and nearly impossible to use in connection with municipal sales taxes.

The sales tax completely ignores ability to pay. Sales taxes apply primarily to those commodities that enter the budgets of the poor. Since the poor spend nearly all of their income as fast as they receive it they

pay a much larger portion of their income in taxes than the wealthy. The regressive nature is further emphasized since the larger part of the income of the wealthy goes for personal services, travel, domestic help and savings, which are not included under the sales tax law.

The amount of income that the low income earner spends for taxes means a reduction in the amount he spends for goods. Since millions are in this group the result is millions of dollars less purchasing power available to this group. Since purchasing is a requisite to prosperity the tax kills the very goal for which we are striving.

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